

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

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subject: Section 7436 Notice of Determination of Worker Classification and Backup  
Withholding

This Chief Counsel Advice responds to your questions about backup withholding issues that may arise in connection with § 7436 litigation.

**ISSUES**

- (1) Whether the Tax Court has jurisdiction over backup withholding.
- (2) Whether the issuance of the § 7436 Notice of Determination of Worker Classification (NWDC) suspends the period of limitations for assessment of backup withholding.

**CONCLUSIONS**

Issue 1:

The Tax Court does not have jurisdiction under § 7436 to determine the application of backup withholding liability for any workers determined to be independent contractors.

Issue 2:

If a Taxpayer filed Forms 945 and thus started the running of the period of limitations on assessment with regard to backup withholding, the issuance of the NDWC may nonetheless suspend the period of limitations with respect to the backup withholding.

## FACTS

A NDWC issued under § 7436 notifies the taxpayer that the Service has determined that one or more individuals performing services for the taxpayer are employees for purposes of subtitle C, the taxpayer is not entitled to relief under section 530 of the Revenue Act of 1978 (section 530) with respect to such individuals, and the taxpayer owes additional employment tax (and possibly additions to tax and/or penalties) on account of such determinations. The NDWC does not determine or propose backup withholding liability. The issuance of the NDWC provides the taxpayer the opportunity to file a pleading in Tax Court to seek review of the Service's determinations. In some cases, the status of workers as employees may ultimately be conceded, settled, or resolved by the court's determination that they are not employees.

## LAW AND ANALYSIS

### Issue 1

Section 7436 grants the Tax Court jurisdiction to verify the determinations by the Service that one or more individuals performing services are *employees* for purposes of subtitle C, that the employer is not entitled to section 530 relief, and the amount related to those determinations. While § 3406 imposing backup withholding is part of subtitle C, the reference in § 7436(a) is to determinations that the individuals in question are employees, that the taxpayer is not entitled to treatment under § 530, and the amounts tied to those determinations, whereas § 3406 contemplates a determination that the individuals performing services are not employees. Consequently, since a controversy for purposes of § 7436 involves a determination that individuals performing services are employees, backup withholding liability for payments to nonemployees cannot arise pursuant to a § 7436(a) determination. Therefore, since Tax Court jurisdiction under § 7436 is limited to the actual controversy that arises pursuant to a § 7436 determination, the Tax Court does not have jurisdiction under § 7436 over the application of backup withholding liability attending a determination (whether due to concession, settlement, or court decision) that certain workers are independent contractors.<sup>1</sup> Rather, the backup withholding liability arises outside of the context of a § 7436 determination and the resulting litigation in Tax Court.

### Issue 2

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<sup>1</sup> We are not addressing whether the Tax Court could have equitable recoupment jurisdiction under § 6214(b).

Generally, under § 6501(a), the Service has three years from the filing of the return to assess tax. Therefore, once a taxpayer has filed a return, specifically Form 945, Annual Return of Withheld Federal Income Tax, the Service will have only three years from the filing date within which to assess.<sup>2</sup> Once the period of limitations on assessment for backup withholding has expired, the subsequent issuance of a NDWC will not revive the period of limitations for assessment.

When the Service determines a deficiency, § 6213(a) prohibits assessment of that deficiency or any levy or proceeding in court for its collection until after the time to petition the Tax Court has expired or, if a petition is filed, until the Tax Court decision is final. This rule is based on the principle that the government should not be able to assess and pursue collection of a tax while a taxpayer's liability for that tax is before the Tax Court for decision. Section 6503(a) provides that the issuance of a statutory notice of deficiency by certified or registered mail will suspend the running of the period of limitations on assessment for the period during which the Secretary is prohibited from making the assessment or from collecting by levy or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter. The principle underlying this provision is that the limitations period for the Service to assess or pursue collection of a tax should not expire or be cut short by the pendency of a proceeding that prevents the Service from assessing the tax.

Section 7436(d)(1) of the Code provides, in relevant part, that the *principles of* subsections (a), (b), (c), (d), and (f) of § 6213, § 6214(a), § 6215, § 6503(a), § 6512, and § 7481 *shall apply to proceedings brought under this section in the same manner as if the Secretary's determination described in subsection (a) were a notice of deficiency* (emphasis added). The "Secretary's determination" described in subsection (a) of § 7436 is the issuance of the NDWC. Therefore, pursuant to § 7436(d)(1), a NDWC is to be treated analogously to a notice of deficiency for purposes of the cited sections of the Code, specifically §§ 6213 and 6503(a).

Section 3406 imposes a tax, backup withholding, only with regard to amounts that are reportable on Forms 1099 if the payee fails to furnish his Taxpayer Identification Number (TIN) to the payor in the manner required, and thus does not include wages paid to employees<sup>3</sup>. Conversely, a proceeding under § 7436 can only be brought when the Secretary has determined that individuals *are* employees. Once a proceeding has

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<sup>2</sup> For purposes of employment tax returns, if a return for any period with or within a calendar year is filed before April 15 of the succeeding calendar year, such return is considered filed on April 15 of such succeeding calendar year. See § 6501(b)(2); Treas. Reg. § 301.6501(b)-1(b).

<sup>3</sup> Section 3406 provides that in the case of a reportable payment, if the payee fails to furnish his TIN to the payor in the manner required, then the payor shall deduct and withhold from such payment a tax equal to the product of the fourth lowest rate of tax applicable under § 1(c), as modified by § 1(i). Section 3406(b)(3) defines reportable payment as any payment of a kind, and to a payee, required to be shown on Form 1099. Section 3406(g) provides that backup withholding does not apply to any amount for which withholding is otherwise required.

begun pursuant to § 7436, the possibility that a taxpayer might be liable for § 3406 taxes will arise only if and when the matter before the Tax Court is resolved (i.e., by concession, settlement, or court decision) that the individuals are not employees. Based on the principles of § 6213(a), the Service should not be able to assess and collect a tax that is potentially inconsistent with the Tax Court's ruling in the proceeding before it, or while that proceeding is pending. Because the Service should not assess and collect the backup withholding liability during the pendency of the Tax Court § 7436 proceeding, the statute of limitations on assessment of the liability should be suspended under § 6503. More specifically, assuming the period of limitations on assessment of § 3406 taxes is open (i.e., three years has not run from the date of filing of a return) when the NDWC is issued, the proper issuance of a NDWC under § 7436(a) should suspend the running of that period with respect to any backup withholding liability pursuant to §§ 6213(a), 6503(a), and 7436(d)(1) for the 90-day period during which the taxpayer can begin a suit in Tax Court, and, if the taxpayer files a timely petition in Tax Court pursuant to § 7436, during the Tax Court proceedings and until the Tax Court decision becomes final, and for 60 days thereafter.

We recognize the potential incongruity in noting that the Tax Court does not have jurisdiction over § 3406 taxes in a § 7436 proceeding while also asserting that the proper issuance of the NDWC suspends the period of limitations with respect to § 3406 taxes. However, due to the unique nature of employment taxes, there is no perfect analogy in the deficiency arena to apply to the operation of § 6503(a), a provision involving income tax deficiencies, in the employment tax arena. The principles we distill above from §§ 6213 and 6503 are especially apt in light of the uniqueness of the situation where assessing one type of employment tax (e.g., backup withholding on non-employees) is inconsistent with assessing another type of employment tax (e.g., social security and Medicare tax on employees). Furthermore, these principles only apply to situations where the period of limitations for assessment of § 3406 taxes is open at the time the NDWC is issued.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



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Please call Ligeia Donis at (202) 622-0047 if you have any further questions.